**IN THE UNITED STATES BANKRUPTCY COURT**
**FOR THE EASTERN DISTRICT OF TENNESSEE**

| | |
|---|---|
| In re<br><br>JOHNNY LEE TIPTON<br>and KELLEY RENEE TIPTON,<br><br>Debtors. | No. 99-21667<br>Chapter 7 |
| T. KEVIN CASTLE<br>and LAUREN CASTLE,<br><br>Plaintiffs,<br><br>*vs*.<br><br>JOHNNY LEE TIPTON,<br>KELLEY RENEE TIPTON,<br>NORWEST MORTGAGE, INC., and<br>RONALD L. PERKINS, TRUSTEE,<br><br>Defendants. | Adv. Pro. No. 99-2042 |

**M E M O R A N D U M**

APPEARANCES:

KELLEY HINSLEY, ESQ.
IRA L. DOVE, ESQ.
Post Office Box 663
Morristown, Tennessee 37815-1131
*Attorneys for Kevin and Lauren Castle*

C.E. BUD CUNNINGHAM, ESQ.
837 West First North Street
Morristown, Tennessee 37814
*Attorney for Johnny and Kelley Tipton*

STEPHEN C. WALLING, ESQ.
1111 Northshore Drive, Suite S-700
Knoxville, Tennessee 37919-4074
*Attorney for Norwest Mortgage, Inc.*

LORI L. JESSEE, ESQ.
BACON, JESSEE & PERKINS
1135 West Third North Street
Morristown, Tennessee 37814-3891
*Attorneys for Ronald L. Perkins*

**MARCIA PHILLIPS PARSONS**
**UNITED STATES BANKRUPTCY JUDGE**

In this adversary proceeding, the plaintiffs allege that the debtors committed fraud by selling them a residence which had a propensity to flood. The plaintiffs seek a rescission of the sale or, in the alternative, damages and a determination that their claim is nondischargeable under 11 U.S.C. § 523(a)(2)(A). The court having concluded after a trial on March 16 and 17, 2000, that rescission is not appropriate, but that the debtors are liable for damages to the plaintiffs and this debt is nondischargeable, a judgment will be entered in favor of the plaintiffs. This is a core proceeding. *See* 28 U.S.C. § 157(b)(2)(B),(I) and (O).

I.

The debtors, Johnny and Kelley Tipton, filed for bankruptcy relief under chapter 7 on June 29, 1999. On Schedule D, the debtors listed unsecured nonpriority claims against them in the amount of $104,583, including $100,000 to the plaintiffs, Kevin

and Lauren Castle, arising out of a pending state court lawsuit. The complaint initiating this adversary proceeding was filed on September 16, 1999, by the Castles against the Tiptons, the holder of the Castles' deed of trust, Norwest Mortgage, Inc., and the named trustee therein, Ronald L. Perkins.

Prior to trial, the parties submitted a joint pretrial statement which supplanted the pleadings and stipulated the foundational facts as follows. On or about January 31, 1998, the plaintiffs entered into a contract with the debtors for the purchase of a newly constructed house at Lot 55 of Westgate subdivision in Hamblen County, Tennessee. A closing on the transfer of property took place at Colonial Standard Title on February 17, 1998. Norwest Mortgage is the holder of the equitable title to the subject property pursuant to a recorded deed of trust, which constitutes the first lien against the real estate, and Ronald L. Perkins is the trustee under that deed of trust. Norwest Mortgage and Mr. Perkins have been joined as parties in this action because of their legal or equitable interest in the subject property, but the priority of lien holders is not at issue. Since February 17, 1998, the debtors have expended considerable time and money to protect against future flooding, including building a levy to prevent flooding of the premises.

The plaintiffs allege that in order to sell them the house in question, the debtors intentionally concealed or misrepresented the propensity of the property to flood and its drainage problems. Because of severe flooding problems experienced by the plaintiffs which they allege have forced them to move from the premises, the plaintiffs request that the sale be rescinded and the parties placed in the same positions they occupied prior to the sale. Plaintiffs also seek damages totaling $32,318.43 for monies they have expended in connection with the purchase and subsequent floods. They demand a judgment against the debtors and a determination that the damages are nondischargeable under 11 U.S.C. § 523(a)(2)(A).

The debtors deny that they had any knowledge regarding the property's propensity to flood or drainage problems and deny that they made any misrepresentations regarding flooding. The debtors deny that there were even the builders of the residence and that they have any special liability as such. To the extent that any misrepresentations were made, the debtors allege that they merged into the written contract between the parties which states that no representations are being made and the buyers are purchasing the property "as is." They note that Mr. Castle is an engineer and Mrs. Castle is a real estate agent and thus they were "more qualified than the average couple to inspect and

satisfy themselves as to the condition of the property." The debtors further assert that the plaintiffs have overstated the severity of the problem and only moved out of the house to increase their damages.

III.

The following testimony was received from the witnesses at trial:

Lauren Castle. Plaintiff Lauren Castle testified that she has a B.A. in Communications. She stated that in January 1998 she and her husband Kevin were living in South Carolina and she was working in outdoor advertising when her husband took a mechanical engineering position with Tuftco Corporation in Morristown, Tennessee. Mrs. Castle testified that on January 31, 1998, while driving around Hamblen County, Tennessee looking at prospective homes, she, her husband, his parents and the plaintiffs' real estate agent, Jan Stallings, saw a three-bedroom house with a basement garage in the final stages of construction at 6741 Colgate Drive, in Talbott, Tennessee, i.e., Lot 55 in Westgate Subdivision. Liking the house immediately, its large lot size and the neighborhood, but having questions regarding the house's completion, Ms. Stallings suggested that the Castles talk with the builder. The Castles and Ms.

Stallings then drove to her office at ReMax where Ms. Stallings telephoned Becky Skelton, the real estate agent for the debtors, who then in turn telephoned them. Mrs. Castle testified that shortly thereafter the debtors met them at the construction site.

While at the site, the parties discussed finishing details in the house and in the yard. At that time, the driveway had not yet been poured and piles of dirt from the basement excavation and construction debris were still standing in the yard. Mrs. Castle described the lot as level in front and then dropping off gradually and leveling out in the backyard where there were a few small puddles of water. Because of these puddles and the lay of the land, Mr. Tipton was asked if he thought there would be a problem with water coming into the basement or standing in the yard. According to Mrs. Castle, Mr. Tipton responded in the negative, that the property was not in a flood zone, that he had an engineer visit the property, that the engineer had given him a report on what to do, and that as soon as it got dry enough he would be landscaping the property and sowing grass. Being satisfied with these answers, the Castles and Ms. Stallings along with the Tiptons went back to the ReMax office where an offer was made and accepted, and a contract signed for a purchase price of $92,900.

On February 17, 1998, the sale was closed and the plaintiffs moved into their new home with the landscaping yet to be completed. Immediately prior to that closing, the parties and Ms. Stallings met back at the house for a final walk-through inspection. Mrs. Castle testified that it had rained the night before, and there were bigger puddles of water standing in the yard than they had seen before. She stated that they asked Mr. Tipton about the water and that he assured them that as soon as the weather permitted, everything would be taken care of and he would have the equipment there to do the landscaping. Mrs. Castle testified that this was the first house she and her husband had ever purchased; in South Carolina, they lived in her grandmother's house.

Mrs. Castle testified that approximately three weeks after they moved into their home, it rained again and she began noticing people in cars slowly driving by and staring at her house. Upon looking in her yard, she discovered that there was a big pooling of water outside her garage doors and that the water was coming into the basement. She telephoned her husband at work; he came home and telephoned Mr. Tipton and told him about the problem. When he had no ideas to help them, the Castles decided to purchase sand bags. Upon returning home, they discovered that the flood water was ankle deep in their

basement and had traveled almost to their water heater, which was more than halfway back in the basement. Mrs. Castle testified that she and her husband packed the sandbags in front of the water heater and cleaned up what they could that evening. By the next morning, most of the flood water had receded from the basement so the Castles used a hose to clean up the mud left by the flood.

Mrs. Castle testified that after this rain she and her husband walked around their yard in order to determine where all the water was coming from that had accumulated in their back yard and basement. Noticing a trickle of water running down the left side of their yard, they discovered upon closer inspection a large drainage pipe that ran under Colgate Drive from the vacant lot across the street, and opened up onto their property. Mrs. Castle testified that this was the first time she and her husband had seen or had any knowledge of the pipe.

Mrs. Castle stated that a week to ten days later, another substantial rain took place, again causing ankle-deep flooding in the basement and requiring the use of sand bags. Again the Castles telephoned the Tiptons advising them of the problem since they had assured the Castles that they would take care of any problem. Mrs. Castle testified that the rain prevented them from using the garage and they had to park in the driveway

because the water shorted out the electrical sensors for the garage doors.

On the Saturday following this rain, Mr. Tipton and another individual came to the house with a bulldozer, graded the yard, sowed grass seed, and planted shrubbery. Two weeks later, it rained again but unfortunately the landscaping did not prevent the basement flooding from reoccurring. Mrs. Castle testified that this flood was worse than the two previous floods due to a heavier rainfall. As in the first two instances, the Castles were forced to use sand bags to prevent the flood water from reaching the back of their basement where they had boxes and tools stored.

By this time, Mrs. Castle had become employed by Bob Mitchell, a realtor with ReMax, where she performed clerical duties. Mr. Mitchell called Mr. Tipton to discuss the flooding problem and it was decided that a berm or levee should be constructed to direct the drainage pipe’s flow of water away from the house to a basin which they would dig at the far left corner of the Castles’ yard.

After a fourth flooding occurred, Mr. Tipton arranged to have the berm and basin constructed. Soon after its construction, on May 7, 1998, it began raining. Mrs. Castle testified that there was no water in the garage when she left

that morning for work, but that in the afternoon she received a call from her husband telling her that she needed to come home as water was flooding the basement. Upon arriving at home, she discovered that her back yard had become a lake with water pouring into her yard from the drainage pipe, flowing over the berm like a waterfall and flooding into her basement. The water in the basement had risen to a level of almost four feet, within inches of reaching the electrical box on the basement wall. Mrs. Castle telephoned the electric company and was advised to turn off the power in the house.

Frightened by the rapid flooding and realizing that they could not stay in the house with no electrical power, the Castles went to a motel to spend the night. Mrs. Castle testified that it took a couple of weeks before the water completely dried out of the basement. The flooding left a substantial amount of mud and caused the basement to mildew, with the walls and floors turning first green and then orange. The mildew along with humid weather resulted in a bad smell emanating from the basement.

Because of the damage caused by the last flooding, the fact that the house had flooded five times in less than two months, and their belief that the house would continue to flood, the Castles did not move back into the house. Instead, after

staying in a motel for five days, they moved into an apartment where they continue to reside.

Mrs. Castle testified that notwithstanding their absence from the house, they have continued to make their monthly mortgage payments to Norwest Mortgage which have totaled $15,683.16 since they vacated the property. The Castles have secured a storage building to store some of their belongings at a cost of $1,320 since May 1998. They have also been paying vacancy insurance on the house. Some furniture, along with wedding presents, college textbooks, a lawn mower, tools, and household items which the Castles had stored in the basement were damaged by the flooding. The Castles seek the recovery of the value of these items as damages, in addition to rescission of their purchase, along with reimbursement for improvements to the home, litigation costs, and an engineering report which they obtained on the property at a cost of $950, for total damages as of the time of trial of $32,318.43.

On cross-examination of Mrs. Castle, it was brought out that the contract between the parties stated that the buyers agreed to accept the property in its “as is” condition. Also, at closing, the Castles received a document entitled “Exemption Notification of Tennessee Residential Properties Disclosure Act” which stated that “Buyer is advised that no representation or

warranties, express or implied, as to the condition of the property and its improvements, are being offered by Seller or Seller's agent and that Buyer should make a thorough and diligent inspection of the property."

Mrs. Castle testified that since she and her husband vacated the property, they have driven by it after substantial rains and noticed pooling of water in front of the garage doors but it is her understanding that no water has gotten into the basement since the last flood on May 7, 1998. She stated that she has no desire to return to the house and that they retained an attorney soon after they vacated the property. In rebuttal, Mrs. Castle testified that she and her husband received at closing a copy of Exhibit 7, the septic permit.

Jan Stallings. Ms. Stallings testified that in January 1998, she was a licensed real estate broker, working as an assistant to Bob Mitchell with ReMax. She testified that the Castles had been working with Mr. Mitchell to find a house and had signed a contract on another house but that the sale had fallen apart at closing. She knew that the Castles needed to find a house they could move into as quickly as possible because everything they owned was in a U-Haul. She drove them around to look at houses the day after their other closing fell through since Mr. Mitchell was unavailable that day. When the Castles

saw and liked the house on Lot 55, but had questions regarding the house's completion, the yard, and standing water in the backyard, Ms. Stallings suggested that they attempt to get in touch with the builder. Ms. Stallings testified that the Castles also wanted to meet the builder since a builder's failure to perform had caused their last attempted purchase to collapse. The Castles and Ms. Stallings then went to the ReMax office, where Ms. Stallings telephoned the Tiptons' realtor, Becky Skelton, and explained that there were some things that the Castles wanted to ask the builder and the urgency of the situation. Ms. Stallings testified as a result of the call, the Tiptons met them at the ReMax office. After discussing the house, it was suggested that they go to the site, which they did.

Ms. Stallings testified that after going in the house and discussing finishing details, cabinets, and floor squeaks which needed to be repaired, they went out in the yard next to the road at the right of the house (facing the house) and discussed driveway placement. Ms. Stallings testified that from that vantage point they could seek water standing in a low area in the backyard so she asked Mr. Tipton about the water. She testified that he told her that he would fill in the low areas when he graded, that he had talked with an engineer and had a

report, that it would be taken care of when the ground dried. He explained his plan and mentioned that there was a possibility that some trees would have to be removed. Ms. Stallings testified that this discussion took place in the presence of the Castles and Mr. Castle's father. She further stated that she was not familiar with the property prior to her visit on that day, that she did not know about the drainage pipe, that she did not see the drainage pipe, and that there was no discussion of the pipe. Afterwards, they went back to the ReMax office and wrote out the contract.

Ms. Stallings testified that she was at the walk-through inspection, and noticed that there was some water in the back yard. She testified that at the closing she asked Mr. Tipton about the water and he told her that as soon it dried up, he would grade and landscape.

Kevin Castle. Plaintiff Kevin Castle testified that he has a mechanical engineering undergraduate degree with an M.B.A. from Clemson University and that he is presently employed as a senior product design engineer, designing transmissions, gears, etc. Mr. Castle testified that on the day he and his wife first visited their house, he personally talked with Mr. Tipton about the small puddles of water in the backyard. Mr. Tipton told him that he had an engineering report and that he planned to grade

the yard, move some dirt around, landscape and sow grass. Mr. Castle testified that he later asked Bob Mitchell to obtain a copy of the report but that it was never provided. Nonetheless, he had a good feeling when he met the Tiptons and was confident that they knew what they were talking about.

Mr. Castle testified that he did not see the drainage pipe in the yard until after the first flooding, although he admitted to walking around the yard the day the contract was signed. He stated that at the time he did not know anything about water drainage as he had not studied civil engineering at all. He stated that the yard's general lay of the land caused him a slight, but not great, concern.

Mr. Castle admitted that at closing he and his wife read and signed Exhibit 39, the Exemption Notification, which stated that the seller was not making any warranties. However, the document also stated that "[t]his is a transfer involving the first sale of the dwelling and the builder is providing a written warranty." Mr. Castle stated that to his knowledge, he never received this written warranty and does not know if he ever got a copy of the title opinion. Mr. Castle conceded that during the floods, the Tiptons made an effort to fix the problem by completing the landscaping and building the berm and pond, and that he knew of no malice that the Tiptons had towards him and

his wife. He stated that if he had known there was no engineering report, he would have investigated further before purchasing the home. He admitted that he had not seen the house flood since 1998 but stated that he did not go by there everyday so he did not know if it had flooded or not.

David Britton. David Britton is a licensed real estate appraiser with offices in Morristown, Tennessee, whose qualifications as an expert was stipulated by the parties. Based on a replacement cost analysis, and valuing the lot at $15,000, Mr. Britton testified that it would cost $95,626 to replace the Castles' house. Using a market approach which compares the house with similar houses recently sold, Mr. Britton concluded that the house was worth $96,000 as of November 22, 1999, assuming no deficiencies with the house, although it was obvious from an inspection of the property that there had been flooding since the basement of the house was covered in mud. In order to ascertain the market value of the house in its present condition, Mr. Britton examined the courthouse records and found five houses that had flooded, two of which had subsequently sold. One house had a 55% decline in value due to the flooding and the other had a 26% decrease in value. Based on these two sales, Mr. Britton opined that the flooding problems reduced the value of the house on Lot 55 by

40%.

Speaking generally about the property, Mr. Britton testified that he would not have considered the property a prime building lot and that he was surprised that anyone would have built on the lot based on its sloped topography. With respect to the possibility of an injection well being constructed on the property to alleviate the flooding as had been suggested by an engineer who had looked at the property, Mr. Britton testified that he had never seen one on a piece of residential property and that such a well would adversely affect the property's value and marketability.

On cross-examination, Mr. Britton admitted that Lot 55 was not in a flood zone and that there was nothing in any of the paperwork on the lot that would suggest flooding problems. He also testified that he was familiar with Westgate subdivision and other houses therein had flooding problems in the past. Although he agreed at one point in his testimony that a lay individual probably would not recognize potential flood areas, it was his opinion that most individuals viewing Lot 55 would or should have a concern because of its low topography and the absence of any visible means for water removal from the property. Mr. Britton stated that he saw the drainage pipe when he made his inspection because he was specifically looking for

it. He noted that it was difficult to tell if the pipe was on Lot 55 or on the adjoining lot because Lot 55 is twice as wide as most of the lots in the subdivision. He said no water was coming out of the pipe when he saw it.

Audry Fielder. Audry Fielder lives in Westgate Subdivision on the property adjoining the Castles' and has lived there since 1988. She testified that all of the water from the neighborhood runs into the Castles' lot, that if it rains steadily over 24 hours, water stands on the property, and that she never thought that anyone would build a house on the lot.

Ms. Fielder testified that on May 7, 1998, she was cleaning out her garage for a garage sale when she noticed the Castles' yard was flooding. She described it as "somebody let a dam loose" and that she could see their "garage doors bow in where the water was getting so high from it." Becoming concerned, she telephoned Kevin Castle at work, told him about the flooding, and suggested that he come home and remove items from his garage before they were damaged. After talking with him, she began recording the flooding on her video camera because she "hadn't seen it flood in such a long time like that." Ms. Fielder stated that the flood water had gotten so deep in the Castles' yard that it was spilling over onto her property and causing a drowning hazard for her minor daughter. It was her testimony

that the flood on May 7, 1998, was the worst she had seen since the spring of 1994 when a flood caused water to stand for six weeks in what is now the Castles' yard. Ms. Fielder stated that water still stands in the yard when it rains steadily but it has not gotten as deep as it did in 1998.

Kenneth Foster. Kenneth Foster owns Lots 58 and 59 which are vacant lots across the street from and which face the Castles' house. Mr. Foster's residence is on a lot which backs up to Lots 58 and 59 and he has lived in Westgate subdivision for 22 years. He testified that Lot 55 always has standing water but that it had never flooded as much as it did on May 7, 1998. Mr. Foster testified that when the basement was being dug on Lot 55, dirt was pushed on and buried the drainage pipe which opened up onto Lot 55. Because the Lot 55 pipe provides the runoff drainage for Lots 58 and 59 through a culvert which runs under the road, the burial of the drainage pipe opening on Lot 55 caused water to back up and stand on his lots. Mr. Foster testified that he complained to Lester Byrd, the contractor who was building the house for the Tiptons, and Mr. Byrd told him that he did not know the pipe was there and that he would talk to Mr. Tipton about the problem. Apparently Mr. Foster did not wait for a reply, because he testified that after talking to Mr. Byrd, he then telephoned Mr. Tipton directly—he believed on two

occasions—and complained. Mr. Foster testified that Mr. Tipton told him that he would not unblock the pipe because he could not have the water running onto his property. Dissatisfied with this response, Mr. Foster telephoned Barry Poole, the county road superintendent, who first came out and looked at the problem and then returned a few weeks later with road equipment to move the dirt from the opening of the drainage pipe and construct a trench for the water to run down the lawn away from the house.

On cross-examination, Mr. Foster testified that the building of the levee also caused water to back up on his two lots and that the owners of Lot 55 prior to its purchase by the Tiptons did not keep the lot mowed regularly but instead allowed weeds and shrubs to grow wild. Mr. Foster also testified that he had not noticed the Castles' property flooding since 1998.

Barry Poole. Barry Poole, who has been Hamblen County road superintendent since 1996, also testified. Mr. Poole stated that he has an undergraduate degree in civil engineering and is a professional land surveyor. He testified that while the house on Lot 55 was under construction, he received telephone calls from both Kenneth Foster and Johnny Tipton, although he could not remember who telephoned him first. Mr. Foster called to express concern about the blocked pipe since in Mr. Poole's

words “he knew that the subdivision more or less drained to that pipe eventually and to Lot 55.” Mr. Tipton called to see if anything could be done to pipe water away from the lot since water would be spilling out directly into the front yard where the house was being built.

Mr. Poole stated that because of these calls, he met with Mr. Tipton at Lot 55 and observed a straight drainage pipe which extended about eight feet into the lot from the street. At that time, the basement had been dug and the block walls for the basement were being laid. He testified that it was clear that Mr. Tipton had a major problem because the water would be draining into the yard right where the house was being built. He stated that he tried to express this concern to Mr. Tipton as respectfully as he could without coming right out and saying “you are fixing to get flooded.” Mr. Tipton asked if the water could be pumped away from the lot in any way. Mr. Poole advised him that it would be virtually impossible to correct the problem with a pump because Lot 55 is lower than anything else around it. Mr. Poole testified that he told Mr. Tipton that the only way that the highway department could help would be to divert the water from the end of the pipe to the side lot line. He cautioned him that even with such a diversion, some of the water would still end up behind the house. Believing that this would

help, Mr. Tipton asked Mr. Poole to go ahead. The highway department placed a twenty-feet long curved piece of pipe at the end of the straight pipe to divert the water to the left property line. The pipe extension, except for the last foot, was then covered with dirt. Mr. Poole stated that after the extension, the opening of the pipe was approximately a 45 degree angle from the side of the house.

On cross-examination, Mr. Poole stated that in his talk with Mr. Tipton they may have discussed that some grading could make the surface water drain to the side of the house rather than toward the front door. He did not recall Mr. Tipton asking him his advice as an engineer, only how the highway department could help him because the county's pipe was aimed right at the house. Mr. Poole opined that he was not sure Mr. Tipton fully appreciated the magnitude of the problem, noting that most people without engineering backgrounds or who are unfamiliar with drainage do not realize how quickly water can gather.

Upon being shown Exhibit 5, the plat for Westgate subdivision, Mr. Poole testified that the plat showed a 12-inch pipe* running under Lots 58 and 59, crossing under Colgate street

*In the debtors' answer and trial brief and in their portion of the joint pretrial statement, the debtors refer to the pipe as being 16 inches in diameter although neither was questioned at trial as to the size of the pipe. The only evidence as to (continued...)

and coming out on Lot 55. The plat also showed a 5-foot drainage easement on Lot 55 several feet to the right of the drainage pipe which easement ran parallel to the side lot line and all the way back to a large circle in the middle of the lot with a smaller circle at the far left corner of the lot. Mr. Poole testified that the circles indicated sinkholes or areas of drainage and described Lot 55 as basically a sinkhole in a "bowl-like area." He stated that it appeared that the foundation for the house was in the same area as the 5-foot drainage easement. Because of the location of the sinkholes and the drainage easement which ran down the middle of the lot, it was Mr. Poole's opinion that there was not a good place on the lot to build a house. Mr. Poole testified that he was a little "amazed" that the health department was able to designate field lines for sewer drainage.

Mr. Poole was also shown Exhibit 7, a copy of the permit that was issued by the health department for the septic system on Lot 55. Drawn on the face of the permit was a hand sketched drawing of the lot which indicated a 5-foot drainage easement perpendicular to the front road footage, two circled low areas,

---

[*](...continued)
the drainage pipe's diameter was Mr. Poole's testimony that the plat indicated a 12-inch pipe. Mr. Poole testified that he had thought that the pipe was 18 inches in diameter, but he assumed that the plat was correct.

and a drainage easement running between the two circled areas. Written beside the drawing of the lot were the instructions: “Stay 25 ft. from low areas. Check plat at courthouse for exact location of drainage easement.” Mr. Poole testified that septic permits are generally obtained before construction commences.

Charles Corlew. Charles Corlew is office manager and vice-president of Barge, Waggoner, Sumner & Cannon, a consulting engineering firm in Morristown, Tennessee. He has a bachelor of science degree in civil engineering and is licensed by the state of Tennessee as a professional engineer. Mr. Corlew testified that the entire portion of west Hamblen County where the Castles’ house is located is underlain by karst terrain which supports an underground water system as indicated by the large number of sinkholes throughout the area. Because of the karst terrain, any drainage system must not only deal with surface water, but also the potential for the underground water which may rise to the surface during high wet periods.

Mr. Corlew testified that he was retained by the Castles to examine their house and lot and propose some remedies to make the property usable. He observed that the site is the lowest within the subdivision and concluded from what had happened that the lot was the natural drainage spot for years for that entire area. Mr. Corlew stated that from his inspection which took

place in the fall of 1999, he found cracks in the basement floor and walls evidencing structural failure and indicative of underground soil movement such as sinkhole activity. From the wetness of the concrete block, he ascertained that moisture was still being experienced. The ground was extremely marshy and wet which meant that water was still holding in the area. In his opinion, the lot has the potential of flooding not only from surface water but also subsurface water.

Mr. Corlew was shown Exhibit 37 which lists climatological data about a mile from this site as recorded by the National Weather Service for 1996 to 1999. The data indicated that between March 31 and June 1, 1998, twelve inches of rain fell, which was five and a half inches more than the average and the rainfall through June 1998 was approximately nine and a half inches above normal precipitation. Rainfall through June 1997 was six inches above normal. Rainfall through June 1999 was almost two inches below normal for the year.

Mr. Corlew was also shown Exhibit 48 which is a letter proposal dated August 5, 1998, for a geotechnical investigation of the Castles' property by Foundation Systems Engineering ("FSE"). Bryan Fowler of FSE states in the letter that "site grading at the time the existing residence was constructed resulted in the filling of the sinkhole located in the rear yard

of the residence" and "in our opinion, filling of the sinkhole has caused the severe flooding problem." In order to provide geotechnical design recommendations that would restore drainage to the sinkhole, FSE proposes in the letter to conduct five soil test borings and certain laboratory soil testing. With the results of this testing, FSE would then prepare an engineering report with its recommendations at a cost of $4,675. The letter noted that possible options at that point would be placement of standpipe into the throat of the sinkhole, placement of an injection well to allow surface water to drain into a deeper aquifer, construction of a drain field leach system, or excavation of the fill soils from the sinkhole with placement of a stone drain.

Charles Corlew testified that in his opinion, because of the low topography of the site, the only drainage solution is the construction of an injection well. Pictures of injection wells at local industrial sites were introduced as Exhibits 31 and 32. The pictures depict a 36-inch diameter black pipe sticking several feet into the air, with a 30-foot radius basin in one picture and a 40-foot radius basin in the other. Mr. Corlew stated that an injection well at the Castles' property would have to be of similar size and would cost $20,000 to $25,000 to build. He noted that permission from the state must be obtained

before an injection well can be built, that the state would then inspect the site, and would probably require a sediment basin to the side of the well.

Mr. Corlew testified that the concrete floor of the basement will have to be augured in order to determine the extent of the damage to the house caused by sinkhole activity and that an investigation of this type would cost about $5,000 or more. Without testing of this type, he was unable to give an opinion as to whether the house is livable. Mr. Corlew noted that if auguring reveals that sediment has occurred beneath the floor, it may be necessary to inject pressure grouting to basically raise the floor back up. Mr. Corlew estimated that this could potentially cost $30,000 to $40,000.

Johnny Tipton. Debtor Johnny Tipton testified that he is 35 years of age and employed as a machine operator at Mahle in Morristown, Tennessee. It was Mr. Tipton's testimony that he and his wife sold the house in question to the Castles, but that he is not the builder, that the house was built by Lester Byrd. Mr. Tipton characterized himself as a contractor, who between 1995 and 1998, had six houses built for resale. Mr. Tipton testified that he purchased the lots, obtained the construction loans, picked the style of house, and then contracted orally with Lester Byrd to build the house for a set price. It was the

Tiptons' practice to move in a house upon its completion, place the newly constructed house and the Tiptons' residence for sale, and then live in the house that did not sell. The house purchased by the Castles was the first house built by the Tiptons in which they had not lived.

Mr. Tipton testified that he purchased Lot 55 in September 1997 for a purchase price of $7,250 because the location is a good selling area. He stated that in order to satisfy himself that Lot 55 was a buildable lot, he ascertained that the lot was not in a flood zone, reviewed the subdivision's building covenants, obtained a title search, and acquired a building permit from the Hamblen County Planning Commission. It was his testimony that neither this research nor the lay of the land alerted him that the property would flood.

On cross-examination, Mr. Tipton admitted that one paragraph of the title opinion indicated "this title opinion excepts any matters which would be revealed by an accurate survey of the premises or any matters which would be revealed by an inspection of the premises." Mr. Tipton also acknowledged that the title opinion stated that the property was "[s]ubject to 5 ft. easement for drainage across lot" and that "[b]y plat of record, Lot 55 is subject to depression areas as shown by plat." Mr. Tipton testified that he did not know what the phrase "subject

to 5 ft. easement for drainage across lot" meant and simply relied on the fact that the opinion did not mention flooding.

Mr. Tipton testified that upon purchasing Lot 55, he had the property bushhogged and then he set the stakes for the location of the house. Mr. Tipton then filed an application for a septic permit with county health department, which sends a representative to the site to direct the placement of field lines. Mr. Tipton testified that as a result of the field lines location, he was required to move the stakes for the house, moving it farther down the hill on the site. He said he assumed that if he was doing something wrong in the construction, the health department would have told him.

Mr. Tipton testified that because of high weeds on the lot and the fact the drainage pipe is below the level of the road, he did not know about the drainage pipe on the property when he purchased the lot. He stated that he learned of the pipe when he went to a neighbor's house to borrow water and the neighbor told him about pipe. Thereafter, he telephoned Mr. Poole and asked him to remove the pipe from the lot because it was an eyesore and because he wanted to build up the front of the yard so that it would be level. The opening to the pipe was considerably below street level due to the steep grade of the yard and if the front yard were built up, the pipe opening would

be under several inches of dirt. Mr. Tipton testified that Mr. Poole refused to remove the pipe but suggested the extension. He denied that there was anything in his discussions with Mr. Poole which would suggest that water would be coming through the pipe and stated that he wished Mr. Poole had told him that the property was going to flood if he thought that was the case.

Mr. Tipton denied ever talking with Kenneth Foster. He stated that he had never seen water coming out of the pipe while the house was being constructed and that if he had known that the pipe would put water on the lot, he would have stopped construction. He admitted that he knew that the pipe was for water runoff, but "thought there was no way that they would put this pipe on there and deliberately flood that lot and it not being flood zone or anything."

With respect to the events which transpired on the day the contract was signed, Mr. Tipton testified that Becky Skelton telephoned his wife, that his wife then called him at work, and then he and his wife both went to Lot 55 and waited on the Castles. When they did not show up despite a 30 to 45 minute wait, his wife telephoned Becky Skelton and then they all met at the ReMax office. Mr. Tipton testified that while at the ReMax office, he answered the Castles' questions regarding the house's completion and that the parties then signed the contract. It

was his testimony that after the contract was signed, he and his wife, the Castles, and Jan Stallings went out to the property site and discussed interior finishes and the driveway placement. Mr. Tipton stated that the Castles knew about the drainage pipe because the pipe was visible from the front porch and he told them that he had never seen any water coming from the pipe. He admitted however that he never expressly told the Castles about the pipe or pointed out the location of the pipe to them. Mr. Tipton denied that there was any discussion of standing water or an engineering report and testified that the only document that the Castles requested that he bring to closing was a copy of the septic permit. He said that he did not have a copy of the septic permit so he went to the health department prior to closing and they gave him a copy of the certificate of completion of septic system, which he gave the Castles at closing.

Mr. Tipton testified that he never saw a copy of Exhibit 7, the septic permit with the drawing showing the low areas of the lot, or Exhibit 5, the recorded plat which reveals the low areas and the 5-foot drainage easement running down the middle of the lot, until the documents were shown to him at a deposition in connection with this lawsuit. He said that Lester Byrd had picked up the septic permit for him because he was at work and

then Mr. Byrd took the permit to the electric company so that electrical power would be turned on at the construction site. When asked if he had checked the plat at the courthouse for the exact location of the drainage easement as directed on the face of the septic permit, Mr. Tipton answered “no,” that he had never done that before, and that the health department always tells you to check the plat. Mr. Tipton stated that he thought he had received a copy of the plat from Robin Smith, the selling agent when he purchased the lot, but that he has learned during these proceedings that the paper he received from Ms. Smith was a copy of the tax map, which did not show the low areas and drainage easement.

Mr. Tipton testified that he never saw any water on Lot 55 until the day the sale with the Castles was closed, when he noticed a good size pond of water around the basement on the driveway side. He stated that at the walk-through inspection on the day of closing, Mr. Castle asked him about the standing water and he told him that when he did the grading work, he was going to slope the yard away from the driveway so that the water would drain away from the yard. Mr. Tipton testified that he first became aware of a water problem at the Castles’ home when they telephoned him the first time water came into the basement and asked where they could obtain sandbags. He stated that he

was unable to come over at that point because he had his daughter with him, but that he went out there the next day. Mr. Tipton testified that he was "worried sick" over the water problem, that he could not believe that it was happening, that he wanted to get out there and grade but that the rain kept coming. After the third time that the basement flooded, Mr. Tipton and an equipment operator, Mr. Turley, went to the Castles and Mr. Turley graded the yard, sloping the land so that water would run away from the house. Mr. Tipton testified that by the time it had flooded for the fourth time, he had talked to numerous people seeking a solution to the problem. At the suggestion of Bob Mitchell and Mrs. Castle, he built the berm and pond. He stated that he also planned to build a French drain around the whole backyard to drain into the pond but that he ran out of time before the May 7 rain.

Exhibit 40 was rain accumulation charts from McGee Tyson Airport in Knoxville, Tennessee. Mr. Tipton testified that the first time the Castles' basement flooded was on March 9, 1998, that the precipitation on that day was .45 inches, and the monthly rainfall accumulation at that point was 1.31 inches. He further testified that the second time the basement flooded was on March 18, 1998, the rainfall that day was 1.25 inches, and the monthly accumulation was 2.79 inches. He noted that it

rained 2.39 inches on April 16, 1998, and 2.38 inches on April 18, 1998, but that rainfall on the day of the worst flooding, May 7, 1998, was only .78 inches. Based on this information, the report from FSE which indicated that filling of the sinkhole has caused a severe flooding problem, and his personal observations that the water in the previous floods had dissipated quickly unlike the flood on May 7, it was Mr. Tipton's conclusion that the May 7 flood was caused by pushing dirt over the sinkhole when the levee was built and the pond dug. On cross-examination, Mr. Tipton admitted that the pond or basin was built in one of the two "low areas" as designated on the plat, but inexplicably stated that dirt was added rather than removed from the area when the pond was constructed. He denied that dirt was moved on the larger "low area" when the yard was originally graded.

Mr. Tipton testified that after the Castles moved out of the house, he retained Brian Fowler, a soil engineer, to attempt to find a remedy to the house's flooding problems. Exhibit 48 is the resulting report by FSE. Mr. Tipton testified that upon obtaining the report, he met with the Castles' attorney and proposed putting three cave drains in the basin in order to reopen that sinkhole. The Castles rejected this idea, stating that they wanted to give the house back instead.

Mr. Tipton expressed regret for the flooding problems experienced by the Castles, but did not feel that he was responsible because he was not aware of any water problems at the time the property was sold to the Castles and he made no misrepresentations to them. He testified that he borrowed $78,000 to construct the house and that this matter has caused him and his wife to file for bankruptcy relief.

Robert P. Mitchell, Jr. Bob Mitchell testified that he is a realtor and the co-owner of ReMax Real Estate Ten. He stated that the first time he saw the Castles' house was at closing and that there was a small amount of water in the backyard at that time. He testified that Lauren Castle started working for him in March 1998 and that she asked him whether he had any suggestions to resolve their flooding problems. One of his suggestions was the construction of the berm to keep the water from running into the backyard. Mr. Mitchell stated that his undergraduate degree was in agriculture and that while pursuing his degree he had taken some courses on how to drain low lands.

Lester Byrd. Mr. Byrd testified that he is a carpenter who built the house now owned by the Castles. He was the contractor for the Tiptons, who paid him approximately $70,000 in three separate payments, with the money being used to pay his subcontractors. Mr. Byrd testified that the house took

approximately four months to build and that he never saw any water accumulate on the lot during that time. He said that he never saw the drainage pipe that opens onto the lot until the highway department uncovered it when the house was already 70% complete. Mr. Byrd acknowledged that he was concerned when he first saw the pipe because it was headed toward the house and was relieved when the county detoured the pipe to the left of the house. He also acknowledged that when you stand behind the house and turn 360 degrees, every point in sight is higher than the lot's backyard.

Mr. Byrd testified that Mr. Tipton had set the corner stakes for the house about 40 feet off the road, but that the health department inspector had them move the house five feet forward so that there would be room for a secondary drain fill. He testified that he built the berm in the location suggested by Mr. Mitchell and that the dirt dug from the basin was spread over the rest of the yard.

When questioned regarding the septic permit, Mr. Byrd testified that he did not read the permit, but instead gave it to his subcontractor who dug the field lines for the septic system. He stated that he never went to the courthouse to look at recorded plats of a subdivision. He admitted that it was important to know where the easements are on a lot before you

build on it, but that he relied on the health department inspector to show him where to build.

Rebecca Skelton. Becky Skelton testified that she is a realtor with ReMax and that she has handled both the purchase and sale of several pieces of property for the Tiptons. She stated that she did not assist the Tiptons when they purchased Lot 55, that the Tiptons dealt directly with the listing agent for the lot, Robin Smith. Ms. Skelton testified that she first saw Lot 55 when the house was under construction and she listed the house for sale. When questioned regarding the closing of the sale to the Castles, Ms. Skelton testified that she was not present at the closing because she was on vacation and that no one ever asked her to produce an engineering report concerning the property. She did not recall if the Tiptons and the Castles met at the property prior to the execution of the contract, nor did she recall any questions from Jan Stallings regarding standing water. Ms. Skelton stated that she had been a realtor since 1995 and the only map that she generally provides to builders is a copy of the tax map.

Robin Smith. Robin Smith testified that she is a realtor and that she was the listing agent for the Kimbroughs, the previous owners of Lot 55. She stated that the lot was on the market for close to a year before it was purchased by the

Tiptons. Prior to its sale, she drove by the lot about once a month, but never saw any water standing on the property and no one ever told her prior to its sale that the property had a water problem. Ms. Smith did not recall having any direct contact with the Tiptons. She said she was notified by the Tiptons' agent, Ms. Skelton, that they wanted to purchase the lot.

Kelley Tipton. Debtor Kelley Tipton testified that she had no explanation as to why she but not her husband signed Exhibit 39, the Exemption Notification form, and that she did not know whether a written builder's warranty was in fact executed and delivered to the Castles as the form represents. Mrs. Tipton admitted that at the time of the purchase by the Castles, she and her husband built and sold houses for profit. She responded affirmatively when asked if she assisted her husband in the design, marketing and decoration of the houses.

With respect to the Tiptons' purchase of Lot 55 from the Kimbrough family, Mrs. Tipton testified that she had seen the lot prior to its purchase and was present at the closing, but that her husband had actually selected the lot. Regarding the events which transpired on the day the contract was signed, Mrs. Tipton testified that she first met the Tiptons at the ReMax office and that after the contract was signed, they all went out

to Lot 55. She denied that she ever met the Castles at Lot 55 prior to the contract being executed as the Castles testified.

Other Evidence. Also introduced into evidence were various photographs taken of the house, the yard, and the flooded basement, along with a video tape of the basement and the yard as it looked on May 7, 1998, at 5:30 p.m. The photos and video showed water gushing out of the drainage pipe and running down the levee. The drainage water had completely filled the basin and had overflowed the levee such that the entire backyard was filled with water apparently several feet high.

IV.

"A purchaser who has been the victim of a misrepresentation or who has been induced to contract through a mistake of material fact mutual to him and his vendor, is afforded by courts both of law and equity with a number of alternate remedies, including actions for rescission and restitution, actions for breach of contract and actions in tort for misrepresentation." *Isaacs v. Bokor*, 566 S.W.2d 532, 537 (Tenn. 1978). The remedy of rescission involves the avoidance, or setting aside, of a transaction and attempts to put the parties in the same position they would have been before the contract. *Harrison v. Laursen*, 1992 WL 301309 at *2 (Tenn. App. Oct. 23,

1992). A party seeking to rescind must restore or offer to restore the consideration received. *Isaacs*, 566 S.W.2d at 538; 22 TENN. JUR. *Rescission, Cancellation and Reformation* § 14 (1999). Thus, in the case of a real estate transaction, the purchaser is required to vacate or offer to vacate the conveyed property and in return is allowed to recover the purchase price or any consideration which he paid for the property.

"Rescission is a remedy which 'should be exercised sparingly and only when the situation demands such.'" *Richards v. Taylor*, 926 S.W.2d 569, 571 (Tenn. App. 1996)(quoting *James Cable Partners v. Jamestown*, 818 S.W.2d 338, 343 (Tenn. App. 1991)). Stated differently, "rescission of a contract is not looked upon lightly. It is available only under the most demanding circumstances." *Robinson v. Brooks*, 577 S.W.2d 207, 208 (Tenn. App. 1978). "[I]f an adequate remedy at law exists, such as an award of damages, rescission will not be granted." *Chastain v. Billings*, 570 S.W.2d 866, 868 (Tenn. App. 1978). "If the parties cannot be put in status quo, or if, due to the passage of time, etc., equity cannot be done, there is no ground for rescission. Thus, a contract will not be rescinded if the parties cannot be placed in status quo." 22 TENN. JUR. *Rescission, Cancellation and Reformation* § 10 (1999).

In the present case, the plaintiffs seek not only a

rescission of the deed between them and the debtors, but also a rescission of the promissory note in the amount of $85,410.00 in favor of Norwest Mortgage which the plaintiffs borrowed to purchase the house from the debtors. The plaintiffs want to be restored to the status that existed prior to the time they signed the purchase contract with the debtors so that they will no longer be liable to Norwest Mortgage on the promissory note. However, even if grounds exist to rescind the transaction between the plaintiffs and the debtors, there is no basis to rescind the transaction between the plaintiffs and Norwest Mortgage. There is no allegation of fraud, misrepresentation, or wrongdoing on the part of Norwest Mortgage. Furthermore, the plaintiffs have not returned or offered to return the money they borrowed from Norwest Mortgage in order to purchase the house. "The court will not grant to a party rescission of so much of the contract as militates against his interest and allow him to retain the benefit of that portion which inures to his benefit or profit." *Baird v. McDaniel Printing Co.*, 153 S.W.2d 135, 138 (Tenn. App. 1941). Thus, in the absence of a proffer of the borrowed funds, the transaction between Norwest Mortgage and the plaintiffs can not be rescinded.

The court recognizes that in light of the circumstances which have befallen the plaintiffs, they may find the necessity

of tendering repayment to Norwest Mortgage before rescission may be permitted to be so incredulous as to be laughable. However, it must be understood that their transaction with Norwest Mortgage is separate and apart from the contract with the debtors. The rescission criteria must be met with respect to each contract. Because it has not, rescission is not an available remedy in this case.

Even so, the plaintiffs insist that rescission is possible, citing the cases of *Cooper v. Cordova Sand and Gravel Co.*, 485 S.W.2d 261 (Tenn. App. 1971), *Crawford v. Keebler*, 73 Tenn. 547 (1880), and *Patton v. McHone*, 822 S.W.2d 608 (Tenn. App. 1991). In *Cooper*, purchasers of a home sued the sellers and the lender, seeking rescission of the purchase contract and exoneration of their liability on the first mortgage. The lender filed a third-party complaint against the builder and developers of the subdivision, which complaint was adopted by the plaintiffs. Although the court found no fraud by the sellers and denied rescission, the court concluded that the developers were guilty of fraud and the builder guilty of negligence. As a result, the court ordered the developers and builder to indemnify the plaintiffs and the lender for any sums which they might be required to pay. *Cooper*, 485 S.W.2d at 265.

The plaintiffs argue that *Cooper* is significant because "the

Court [therein] did not even consider that the outstanding mortgagees' interest might somehow restrict the Court's equitable powers to do complete justice in the case by ordering rescission" and the case "shows that the Courts are empowered to apply equitable measures and alter contractual obligations even though a mortgage institution may be involved as a party." In *Cooper*, however, it was not necessary for the court to address whether rescission as against the lender was available because the court found no grounds for rescission against the sellers. Accordingly, this court can attach no significance to the absence of a discussion regarding rescission as to the mortgage holder. This court does find it noteworthy that the remedy ordered by the *Cooper* court protected not only the defrauded purchaser but also the lender who like the purchaser was not guilty of any wrongdoing and that by ordering an indemnification, the court apparently concluded that the parties could be made whole with a judgment for damages. *Id.*

In *Crawford*, the court permitted rescission of a contract for the sale of land and promissory notes executed in connection therewith based on the fact that the seller committed fraud and did not have title to the property sold. The plaintiffs asserts that *Crawford* "stands for the proposition that a Tennessee Court is willing to rescind a contract where there is a third party

note holder who may be financially injured." However, the buyer in *Crawford* had not financed the purchase through a third-party lender as in the present case. Instead, the seller himself financed the purchase, but directed that one of the promissory notes be placed in the name of a third person in order to satisfy a debt that the seller owed. Thus, unlike Norwest Mortgage in this case, the third-party in *Crawford* had not expended any monies in connection with the land sale and could still recover the amount owed from its original obligor. In light of this critical distinction in facts, *Crawford* has no relevance to the present case.

The plaintiffs cite *Patton* for the proposition that "[r]escission has often been granted in the cases regarding automobiles where notes have been canceled and lenders prevented from collected deficiencies." However, in *Patton* the seller of the automobile had financed the purchase and then subsequently sold the contract to a third party. *Patton*, 822 S.W.2d at 618. The court concluded that the third-party assignee stood in the seller's shoes and was subject to all of the liabilities of the seller. *Id*. Again, the present case is distinguishable because the plaintiffs' liability to Norwest Mortgage arose from a separate transaction between the plaintiffs and Norwest, rather than from an obligation to the debtors which was assigned to

Norwest Mortgage.

Lastly, plaintiffs argue that Norwest Mortgage is no less innocent than plaintiffs, that Norwest Mortgage could sue its appraiser, or the debtors in this case, and that to hold that rescission is not permitted where the house is subject to a mortgage contract would as a practical matter prevent rescission in even the most egregious cases of fraud since most houses are financed. With respect to the argument regarding the relative innocence of the parties, plaintiffs should understand that the court is not implying that Norwest Mortgage is more innocent and therefore more worthy of protection by this court. In order to grant rescission, "the court requires equity at the hands of the complaining party as well as from the defendant." *Baird*, 153 S.W.2d at 138. "[W]hen a court of equity obtains jurisdiction, it will proceed to administer full equity, and adjust the rights of all the parties, and give complete relief." *Id.* If the court were to grant rescission of the sale and release the plaintiffs from liability under the promissory note without restoring to Norwest Mortgage the funds it loaned the plaintiffs, equity would not be administered to Norwest Mortgage and the parties would not be restored to their status quo, regardless of the possibility Norwest Mortgage may have a cause of action against others.

The court recognizes, as plaintiffs charge, that this ruling in effect denies rescission as an available remedy in the majority of fraud cases involving the sale of residential property since most are financed through a third-party lender. However, the legal requirements for rescission are simply not met under these circumstances. Unless the parties can be returned to their status quo and complete equity can be done, rescission as a remedy is inappropriate. *See* GIBSON'S SUITS IN CHANCERY § 399 ("The object of rescission is to return the parties to status quo. If this cannot be reasonably accomplished, the plaintiff is relegated to a monetary recovery.").

V.

As a alternative to rescission, the plaintiffs seek a judgment under Tennessee law for the damages sustained by them due to the debtors' alleged fraudulent misrepresentations and a determination that the judgment is nondischargeable under 11 U.S.C. § 523(a)(2)(A). In order to establish fraud under Tennessee law, a plaintiff must show that: (1) the defendant made a representation of existing or past fact; (2) the representation was false; (3) the representation was in regard to a material fact; (4) the representation was made knowingly, or without belief in its truth, or recklessly; (5) plaintiff

reasonably relied on the representation; and (6) the plaintiff suffered damage as a result.

*First Nat'l Bank of Centerville v. Sansom*, 1998 WL 57307 at *2 (6th Cir. Feb. 2, 1998)(citing *In re Bursack*, 163 B.R. 302, 305 (Bankr. M.D. Tenn. 1994)). Each of these elements must be proven by a preponderance of the evidence. *See Hendrix v. Insurance Co. of N. Am.*, 675 S.W.2d 476, 480 (Tenn. App. 1984).

Section 523(a)(2)(A) of the Bankruptcy Code excepts from discharge a debt "for money ..., to the extent obtained, by ... false pretenses, a false representation, or actual fraud...." In order to fall within this section, a creditor must establish that: "(1) the debtor obtained the money through a material misrepresentation that, at the time, the debtor knew was false or made with gross recklessness as to its truth; (2) the debtor intended to deceive the creditor; (3) the creditor justifiably relied upon the false representation; and (4) its reliance was the proximate cause of the loss." *Rembert v. AT&T Universal Card Serv., Inc. (In re Rembert)*, 141 F.3d 277, 280-281 (6th Cir. 1998). The standard of proof is the same as that for fraud under Tennessee law. *Id.* at 280 (preponderance of the evidence).

It has been noted that the elements to establish fraud under Tennessee law are "virtually identical" to those required for a

fraud finding under § 523(a)(2)(A). *Bursack v. Rally Hill Prod., Inc. (In re Bursack),* 163 B.R. 302, 305 (Bankr. M.D. Tenn. 1994). However, this observation was made prior to the United States Supreme Court's ruling in *Field v. Mans*, 516 U.S. 59 (1995), wherein the court concluded that the reliance standard for § 523(a)(2)(A) was the subjective "justifiable" rather than the objective "reasonable." Because reasonable reliance is a higher, more demanding standard than justifiable, it has been held that a finding of reasonable reliance necessarily incorporates justifiable reliance. *See HSSM #7 L.P. v. Bilzerian (In re Bilzerian)*, 100 F.3d 886, 892 (11th Cir. 1997); *Harris v. George (In re George),* 205 B.R. 679, 681 (Bankr. D. Conn. 1997); *Kuzniar v. Keach (In re Keach)*, 204 B.R. 851, 854 n.2 (Bankr. D.R.I. 1996). Accordingly, to the extent the court determines under Tennessee law that the plaintiffs reasonably relied on representations made by the debtors, the justifiable reliance standard of § 523(a)(2)(A) has been met.

The first element which the plaintiffs must establish for fraud under Tennessee law is that the debtors made a false representation as to a past or existing fact. The plaintiffs and Ms. Stallings testified that at both the initial meeting at the house with Mr. Tipton and at the walk-through inspection prior to closing, Mr. Tipton was asked about potential flooding

because of the steepness of the lot and standing water in the backyard. All three testified that Mr. Tipton told them there would not be a water problem, that he had talked with an engineer who given him a report on what to do, and that as soon as it was dry enough he would do the grading and landscaping to take care of the matter. Although Mr. Tipton denied that there was any water when he first met the plaintiffs at the site or that he ever mentioned talking with an engineer or a report, Mr. Tipton admitted that there was a considerable amount of standing water on the day of closing and that Mr. Castle asked him about it.

Based on a consideration of all the evidence, the court finds the plaintiffs' version of Mr. Tipton's statements to be the most credible. Almost every witness who testified mentioned the steepness of the lot and the fact that the backyard was the lowest site in the entire subdivision. In light of this terrain, it would be logical for any prospective purchaser to be concerned about and question whether the basement would flood, especially if water were standing at all in the backyard as it admittedly was on the day of closing. The court believes that in order to alleviate the plaintiffs' concerns about flooding and to lend credence to his assurances, Mr. Tipton told the plaintiffs that the property would not flood, that he had talked

with an engineer about the site, and therefore he knew what to do to prevent flooding. These statements were false as there was no evidence that, prior to the closing, the debtors had ever talked to an engineer for the specific purpose of determining the propensity of Lot 55 to flood and ways to control it as Mr. Tipton's general statements to the plaintiffs led them to believe. It is significant to note that when Mr. Tipton first described his conversations with the health department inspector, he referred to her as a "ground water soil engineer" although there was no evidence that she was in fact an engineer. It is no leap to conclude that Mr. Tipton similarly referred to talking with an engineer when he gave assurances to the plaintiffs.

The court also concludes that the debtors' failure to advise the plaintiffs of the drainage pipe was a misrepresentation. Mr. Tipton admitted that he did not specifically point out the pipe to the plaintiffs. Even though the opening of the pipe is visible from the front porch, it is very likely that the plaintiffs did not notice the pipe when they first viewed the house since the pipe was almost entirely covered with dirt and angled away from the house at 45 degrees. Ms. Stallings testified that because the ground was wet that day and the finished grading had not been done, the parties stood in the

road on the side of the house away from the pipe and talked about the driveway and standing water. In light of the condition of the yard, it is unlikely that the plaintiffs spent much time walking around the property. Furthermore, the court found the plaintiffs credible when they testified that they did not know about the pipe until after the first flooding. "The concealment of a material fact which is known to the seller but not the buyer may constitute a misrepresentation.... It is also well-established that the concealment of a material fact, where there is a duty to speak, is equivalent to a fraudulent misrepresentation." *CGR Inv., Inc. v. Hackney Petroleum, Inc.*, 1997 WL 104116 at *6 (Tenn. App. March 10, 1997). *See also McCoy v. James (In re McCoy)*, 114 B.R. 489, 498 (Bankr. S.D. Ohio 1990)(debtor's silence may constitute a materially false misrepresentation).

The next required showing for fraud is that the misrepresentation or omission "was in regard to a material fact." A false representation is material if it would have "influenced [the party's] judgment or decision in entering into the contract." *CGR Inv.*, 1997 WL 104116 *6. Materiality has been similarly defined when interpreting § 523(a)(2). *See Swanson v. Tam (In re Tam)*, 136 B.R. 281, 286 (Bankr. D. Kan. 1992)(misrepresentation is "material" if it would likely affect

the conduct of a reasonable person with regard to the transaction in question). The propensity of a lot to flood and whether an expert has been consulted regarding potential drainage problems are important considerations when buying a house on a steep lot with a low "basin-like" backyard. Mr. Castle testified that if he had known that no engineering report existed, he would have investigated further before purchasing. Similarly, the presence of a large drainage pipe opening onto the property is a matter which would likely have affected the plaintiffs' purchase decision. At a minimum the pipe was an "eyesore" as characterized by Mr. Tipton. Accordingly, materiality has been established.

The fourth element to establish fraud under Tennessee law is that the material misrepresentation was made "knowingly, or without belief in its truth, or recklessly." Similarly, but not identically, section 523(a)(2)(A) of the Bankruptcy Code requires a finding that the debtor knew the representation was false or "made with *gross* recklessness as to its truth." [Emphasis supplied.] Thus, it appears that under Tennessee law, a reckless misrepresentation will suffice, while in order to be nondischargeable, the misrepresentation must have been made with "gross" recklessness, absent a knowing falsehood.

This court concludes that both of these standards have been

met in the present case. Mr. Tipton knew that he had not consulted with an engineer regarding Lot 55's propensity to flood and ways to ensure that flooding did not occur. Thus, his statement that he had was a known falsity. With regard to Mr. Tipton's statements that the lot would not experience water problems, there was no evidence that the debtors knew that the lot would flood to the extent it did and intentionally misrepresented this fact. Nonetheless, Mr. Tipton's statements to the plaintiffs regarding water on the property were grossly reckless. Mr. Tipton knew that a large drainage pipe opened onto the property and from all of the evidence save Mr. Tipton's own testimony, he knew that water would be draining from the pipe onto the property. Mr. Tipton testified that he had been alerted to the pipe's existence by a neighbor and it is not likely that the neighbor told him about the pipe but failed to mention that water came out of the pipe as Mr. Tipton asserts.

Furthermore, the testimonies of both Messrs. Kenneth Foster and Barry Poole were credible. The neighbor Mr. Foster stated that he had complained to Mr. Tipton that the blocked pipe caused water to back up on his property, thus alerting Mr. Tipton to the fact that water from other lots in the subdivision drained out of the pipe into Lot 55. Mr. Poole testified that

Mr. Tipton questioned whether water from the pipe could be pumped away from the lot and he explained to him that even with the diversion, some water would still end up behind the house. In light of these conversations, Mr. Tipton's assertion that he did not know that water would be draining out the pipe was not believable. Why put a extension on the pipe extending the pipe to the lot sidelines if not to divert the flow of water? Because Mr. Tipton knew that some water from the pipe would flow to the backyard and that the lot was "subject to depression areas" and "subject to 5 ft. Easement for drainage across lot" as set forth in the title opinion, Mr. Tipton's statements that the lot would not have water problems were grossly reckless.

The evidence also established that the plaintiffs reasonably relied on Mr. Tipton's representations. The plaintiffs knew that Mr. Tipton had built several other houses for resale and there was no evidence that he had any problems with those houses. From all appearances, Mr. Tipton was an experienced builder who knew what he was talking about. This was the first home purchased by the plaintiffs and although Mr. Castle was a mechanical engineer, he testified that he had no civil engineering classes and knew nothing at the time about water drainage problems. Similarly, Mrs. Castle had no specialized knowledge of real estate or water drainage matters at the time.

Furthermore, the court concludes that the plaintiffs' reliance on the debtors' misrepresentations was the proximate cause of the damages sustained by the plaintiffs. It was Mr. Tipton's theory that the flooding was caused by the construction of the berm and the basin at the far left corner of the property, which construction was suggested by Bob Mitchell. Mr. Tipton noted that the May 7 flood which took place after the basin was constructed was the worst but that the rainfall on that day had been less than on the other flood days. He also referenced the FSE letter wherein the writer opined that the flooding was caused by the filling of the sinkhole.

Regardless of whether the basin construction contributed to the problem, the fact remains that the house flooded on four occasions prior the basin's construction. Water flowed from the drainage pipe into the yard even before the basin was constructed and Mr. Tipton freely admitted at trial that "if that pipe was not on that property, we would not be sitting here today." Mr. Tipton's failure to advise the Castles of the pipe and his false representations which led the Castles to believe that an engineer had examined the property and made recommendations to ensure that the lot would not flood, caused the plaintiffs to purchase a house which apparently never should have been built.

The only other element of either § 523(a)(2)(A) or Tennessee common law fraud which has not been addressed is the requirement under § 523(a)(2)(A) that the debtor "intended to deceive the creditor." The Sixth Circuit Court of Appeals has held that a representation made with gross recklessness as to its truth and with the knowledge that it would induce a creditor to act fulfills the "intent to deceive" element of § 523(a)(2). *Coman v. Phillips (In re Phillips)*, 804 F.2d 930, 934 (6th Cir. 1986). The evidence established that prior to purchasing the house, the plaintiffs desired to talk to the builder to discuss, among other things, whether the lot had any potential water problems. The debtors knew that the plaintiffs needed to make a decision in a hurry, the purchase of another home having fallen through the day before, and that all of the plaintiffs' belongings were in a U-Haul truck. Mr. Tipton's statements regarding the lack of water problems and that he had talked with an engineer were designed to alleviate the plaintiffs' concerns so that they would purchase the house. Thus, the misrepresentations were made with the knowledge that they would induce the plaintiffs to purchase the house. The intent to deceive element has therefore been met.

VI.

As a defense to the plaintiffs' fraud action, the debtors allege that to the extent any misrepresentations were made, they merged into the written contract between the parties which states "Buyer(s) agree to accept this property in its 'AS IS' condition...." They also note that Exhibit 39, the Tennessee Residential Property Disclosure Act Exemption Notification signed by the Castles and Mrs. Tipton on January 31, 1998, provides that "Buyer is advised that no representation or warranties, express or implied, as to the condition of the property and its improvements, are being offered by Seller or Seller's Agent...."

With respect to the debtors' merger argument, there is no boiler-plate merger language in the contract. While the "as is" and no warranty language could possibly bar an action for breach of contractual or implied warranties, it is no impediment to the tort of fraud. *See First Nat. Bank of Louisville v. Brooks Farms*, 821 S.W.2d 925, 928 (Tenn. 1991)("Tennessee law 'gives no effect to disclaimers in the presence of fraud'...."); 37 AM. JUR. 2D *Fraud & Deceit* § 388 (1999)("It is fairly well established that an affirmative provision of an agreement that property is taken "as is" or "with all faults," or in other words, under the condition in which it is, does not preclude a representee from

establishing fraud in respect to false representations made by the representor disposing of such property, in reliance on which representations the transaction is actually consummated.").

A similar argument was raised and rejected by the court in *Edmondson v. Coates*, 1992 WL 108717 (Tenn. App. May 22, 1992), wherein purchasers sought to rescind a contract for the purchase of real estate based on intentionally or negligently made misrepresentations about the susceptibility of the property to flooding and fraudulently concealed defects in the structure of the house. The defendants therein had cited the case of *Atkins v. Kirkpatrick*, 823 S.W.2d 547 (Tenn. App. 1991), wherein the court refused to rescind a contract based on mutual mistake of fact in light of a contractual "as is" provision. The *Edmondson* court distinguished *Atkins* noting that, unlike the case before it, there was "absolutely no evidence [in *Atkins*] that either the sellers' real estate agent or the sellers possessed knowledge of the defective condition of the property." *Edmondson*, 1992 WL 109717 at *10 (citing *Atkins*, 823 S.W.2d at 552). The *Edmondson* court went on to state that:

> Although the courts will enforce "as is" clauses allocating the risk of unknown defects to the buyers, to do so where the sellers knew about the defects and withheld that material information would be to blindly enforce a contract obtained by fraud. Justice would be poorly served if that were the law in Tennessee. Happily, it is not.

*Edmondson*, 1992 WL 108717 at *11.

The debtors also maintain that they were not the builders of the house in question and therefore they have no special liability as such. However, the plaintiffs have not asserted any cause of action against the debtors based on builder liability or warranty. Instead, the plaintiffs contend that the debtors are guilty of common law fraud, to which their status as builder rather than owner-seller is not relevant.

The debtors also note that Mr. Castle is an engineer and Mrs. Castle is a real estate agent and argue as such that the plaintiffs were "more qualified than the average couple to inspect and satisfy themselves as to the condition of the property." However, Mr. Castle is a mechanical rather than a civil engineer and it was his undisputed testimony that he had no training in civil engineering or water drainage matters. Mrs. Castle did not become a real estate assistant until June 1998; she had no experience or training in real estate matters at the time the house in question was purchased and had never even purchased a house before. Although any special skills or knowledge of the plaintiffs would be relevant to the issue of whether their reliance on Mr. Tipton's representations would be reasonable, there was no evidence of any such specialized knowledge. Accordingly, the debtors' argument on this point is

without merit.

VII.

All of the misrepresentations and failures to disclose in this case were made by Mr. Tipton. There was no evidence that Mrs. Tipton participated in any of the conversations regarding water problems on the property. Nonetheless, Mrs. Tipton has also been sued in this matter and the plaintiffs seek to have any debt adjudged against her declared nondischargeable.

The evidence did establish that Mr. and Mrs. Tipton were partners in the house building ventures including the one sold to the plaintiffs. The lots were purchased in both their names and Mrs. Tipton would pick out colors and fixtures for the various houses. There is no question that under Tennessee law all partners are liable for the fraud of one committed in furtherance of the partnership. *See, e.g., Griffin v. Bergeda*, 279 S.W. 385, 386 (Tenn. 1926)(false representation by one partner by means of which property was obtained by the partnership will be imputed to other partners to the extent of holding them civilly liable for the debt). Thus, Mrs. Tipton is equally liable with her husband for the damages sustained by the plaintiffs.

Furthermore, the Sixth Circuit Court of Appeals has held

that for dischargeability purposes of § 523(a)(2)(A), the fraud of one partner can be imputed to another partner who had no actual knowledge of the fraud. *See BancBoston Mortgage Corp. v. Ledford (In re Ledford)*, 970 F.2d 1556, 1561-62 (6th Cir. 1992). In reaching this conclusion, the court relied in part on a Fifth Circuit Court of Appeals decision wherein a husband and wife were partners in several partnerships and the court imputed the fraud of a husband to his innocent wife, based on the fact that (1) the husband and wife were partners; (2) the husband committed fraud "while acting on behalf of the partnership in the ordinary course of the business"; and (3) as a partner, the wife "shared in the monetary benefits of the fraud." *Id.* at 1562 (citing *In re Luce*, 960 F.2d 1277 (5th Cir. 1992)). *See also Lail v. Weaver (In re Weaver)*, 174 B.R. 85, 89 (Bankr. E.D. Tenn. 1994). Because all three of these factors are present in this case, the debtors' obligation to the plaintiffs is nondischargeable not only as to Mr. Tipton, but to Mrs. Tipton as well.

VIII.

In an action for damages caused by a fraudulent misrepresentation, the plaintiff is entitled to recover for all losses proximately caused by the tortious conduct. *Haynes v.*

*Cumberland Builders, Inc.*, 546 S.W.2d 228, 233 (Tenn. App. 1976). Generally, these losses include direct losses, i.e., "the difference between the value of what he has received in a transaction and its purchase price or other value given for it" and consequential damages, that is, "the pecuniary loss suffered otherwise as a consequence of the recipient's reliance upon the misrepresentation." *Boling v. Tennessee State Bank*, 890 S.W.2d 32, 35 (Tenn. 1994).

The direct loss component has been referred to as the benefit of the bargain rule. *Haynes*, 546 S.W.2d at 233. As stated by the Tennessee Court of Appeals in *Haynes*:

> This measure of damages allows the plaintiff to recover the difference between the actual value of the property be [sic] received at the time of the making of the contract and the value that the property would have possessed if [the defendant's] representations had been true. [Citations omitted.] The application of this measure of damages compels the defendant to make good on the false representations. The measure of damages and the fixing of the value of the property are to be determined as of the time of the transaction.
>
> ....
>
> ...In a land sale transaction, the contract price is strong evidence of what would have been the value of the land had it been as represented.

*Id.* at 233-34.

Based on the purchase price, the value of the house had it been as represented, was $92,900 as of February 17, 1998. David

Britton, the real estate appraiser, concluded that the house's flooding problems reduced its value by 40%, which as a result would make the house in worth only $55,740. Thus, the plaintiffs are entitled to recover the difference in these values, *i.e.*, $37,160.

Consequential damages sustained by the plaintiffs include the personal items damaged in the flood which totaled $2,254, the purchase of 42 sandbags at $100, and the expenses incurred when they were forced to stay in a motel for five nights after the May 7, 1998 flood in the amount of $321.68. Closing costs, improvements to the house, house payments made by the plaintiffs, insurance expenses, and yard maintenance expenses are not recoverable as these are not losses proximately caused by the debtors' misrepresentations, but are expenses the plaintiffs would have incurred if the house had been as represented by the debtors. The plaintiffs' rental of a storage building at $55.00 a month since May 1998 is not recoverable because the evidence did not establish that the house could not have been utilized by the plaintiffs for storage. Any award of the requested costs of litigation shall await the filing of a bill of costs pursuant to Fed. R. Bankr. P. 7054(b) and 28 U.S.C. § 1920.

FILED: June 30, 2000

BY THE COURT

_____
MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE